

Internal Revenue Service

Number: **201718020**
Release Date: 5/5/2017
Index Number: 954.02-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
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Refer Reply To:
CC:INTL:B05
PLR-126741-16

Date:
February 09, 2017

Legend

A=
CFC=
Country A=
Parent=
US Sub=
Corp A=
Corp B=
Regulator=
Day X=
Insurance Regulations=
Rule I=
Rule II=
Date A=
Date B=

Dear :

In a letter dated A, you requested a ruling allowing CFC to use certain foreign statement insurance reserves in computing foreign personal holding company income under section 954 on the grounds that these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). Specifically, you requested permission to use (1) the underwriting reserves and loss reserves for life insurance contracts reported by CFC on its Country A annual report; and (2) the underwriting reserves and loss reserves attributable to its noncancellable and guaranteed renewable accident and health ("A&H") contracts reported by CFC on its Country A annual report.

The rulings contained in this letter are based upon information and representations submitted by Parent and accompanied by a penalty of perjury

statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Parent is a publicly-traded domestic corporation that is engaged, through its subsidiaries and affiliates, in various lines of business, which include property and casualty insurance, life insurance, retirement products, mortgage insurance and financial services. Parent owns all the stock of US Sub. US Sub owns all of the stock of Corp A. Corp A owns all of the stock of Corp B. Corp B owns all of the stock of CFC. Parent represents that CFC is a controlled foreign corporation as defined in section 957.

CFC is engaged principally in the underwriting of life insurance contracts and accident and health contracts in Country A. Country A regulates any insurance business conducted in Country A through its insurance laws and regulations. Regulator is responsible for enforcing insurance laws and regulations in Country A. An insurance company must obtain a license from Regulator to conduct an insurance business in Country A.

CFC is licensed by Regulator to sell life insurance and annuity contracts to persons in Country A and is subject to regulation by Regulator as a life insurer. CFC does not carry on business other than life insurance and certain activities that are incidental to the life insurance business. CFC derives more than 50 percent of its aggregate net written premiums from the issuance of life insurance contracts covering applicable home country risks. No policyholder, insured, or beneficiary to a life insurance or annuity contract that CFC issues is a related person as defined in section 954(d)(3). Parent has represented that CFC would be subject to tax under Subchapter L if it were a domestic corporation.

CFC issues health and personal accident insurance contracts that are noncancellable or guaranteed renewable, cancellable, or riders to a life insurance contract. CFC holds reserves with respect to such noncancellable health and personal accident insurance contracts which it treats as life insurance reserves. Generally, CFC does not receive premiums from any insurance contract in connection with the life or health of a resident of the United States or from a related party.

As required by Country A's insurance laws and regulations, CFC files an annual report and financial statements with Regulator. The annual report is audited by external accounting auditors. The accounting records of CFC that form the basis for preparing the annual report are subject to inspection by Regulator at any time. The annual report is made available to the public. In addition to its use for regulatory purposes, the annual report is used for financial purposes, such as Country A credit rating, by lenders, and the public. Day X is the official year-end for CFC.

CFC has appointed a qualified actuary to be involved in matters designated by Regulator as actuarial matters, including the application of appropriate method of reserve calculation and the preparation of the actuarial report. The actuary must have knowledge and experience concerning actuarial matters, and meet requirements prescribed by Regulator. The actuary is required to prepare the annual report and certify to Regulator whether or not the reserves relating to the insurance contracts prescribed by Regulator are established and maintained in accordance with actuarial soundness.

To comply with Country A's insurance laws, CFC must establish and maintain certain reserves for its obligations to holders of its life insurance contracts and to set forth the amount of such reserves on the annual report. The reserves at issue in this ruling request are limited to the underwriting reserves and loss reserves that CFC maintains on its books for life insurance contracts. Country A insurance and reinsurance companies are subject to Insurance Regulations that target a minimum level of capital to ensure that each insurer maintains a capital adequacy level that is commensurate with its risk profile at all times. The Insurance Regulations generally require a company to develop a risk-based level of regulatory capital targeting the optimal capital level over and above the prudent estimate reserve.

Underwriting reserves are required to secure the performance of future obligations arising from insurance contracts. Underwriting reserves consist of the present value of future benefits plus future expenses, minus the present value of future gross (contract) premiums, all under reasonably current interest, mortality, morbidity, and lapse assumptions. Under Rule I, the reserves include provision for moderately adverse deviation. Under Rule II, the reserves are developed on a best estimate basis. This method is commonly referred to as the Gross Premium Valuation ("GPV") method. Generally, the Insurance Regulations call for the use of the GPV method, which is a methodology used by the insurance industry throughout Europe and Asia. For the fiscal year ended on Date A, CFC used the GPV method in accordance with Rule I to compute all of its insurance reserves as reflected in its annual report required to be filed with Regulator. For fiscal years beginning on and after Date B, CFC intends to use the GPV method in accordance with Rule II to compute all of its insurance reserves as will be reflected in its future Country A annual reports filed with Regulator.

CFC may also hold loss reserves for outstanding claims (including claims that have been incurred but not reported) from insurance contracts issued by CFC. CFC calculates the loss reserves using the company's individual loss experience, in accordance with the rules and regulations prescribed for these reserves by Regulator. Under Rule I, the loss reserves include a contingency provision for adverse deviation above the best estimate; for Rule II, the loss reserves are developed on a best estimate basis.

Parent represents that:

- (1) CFC is not engaged in any insurance business outside of Country A and does not carry on non-life insurance business other than certain businesses which are incidental to the life insurance contracts and accident and health contracts.
- (2) The net written premium income received by CFC for the year ending on Date A is representative of the net written premium income generally received by CFC.
- (3) Any difference in the methods under Country A law used to calculate the reserves related to an insurance policy issued by CFC as compared to the methods used to calculate such reserves for the same insurance policy under Subchapter L (if CFC were a U.S. insurance company) would not cause a material difference in the measurement of CFC's income during the life of such policy.
- (4) The foreign reserve method used to calculate CFC's underwriting and loss reserves is not contrary to the rules and principles applicable to the calculation of reserves under Subchapter L, as modified by section 954(i).
- (5) Each contract covered by the rulings requested is (i) a life insurance contract, as defined in section 953(e)(5), determined without regard to sections 72(s), 101(f), 817(h), and 7702; (ii) regulated as a life insurance contract by Regulator; and (iii) no policyholder, insured, or beneficiary with respect to the contract is a United States person.
- (6) The noncancellable and guaranteed renewable A&H policies included in the rulings requested are only "noncancellable life, health, or accident insurance policies" within the meaning of Treas. Reg. § 1.801-3(c) or "guaranteed renewable life, health, and accident insurance policies" within the meaning of Treas. Reg. § 1.801-3(d).
- (7) The underwriting reserves and loss reserves at issue in the rulings requested do not include (i) deficiency reserves, (ii) contingency reserves, (iii) equalization reserves, (iv) excess interest reserves for excess interest credited beyond the end of the taxable year, or (v) any reserves for accrued liabilities that under the accrual method meet the "all events test" (as described in Treas. Reg. §1.446-1(c)(1)(ii)).

Law

In general, a United States shareholder of a controlled foreign corporation ("CFC") must include in gross income its pro rata share of the CFC's Subpart F income for each year. Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954.

Section 953(a)(1) defines the term “insurance income” to include any income which is attributable to issuing or reinsuring of an insurance or annuity contract, and which would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953(a)(2) provides that section 953 insurance income does not include “exempt insurance income” derived by a “qualifying insurance company.” Section 953(b)(3) provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

Section 953(e)(1) defines exempt insurance income as income derived by a qualifying insurance company which is attributable to the issuing (or reinsuring) of an exempt contract by such company and is treated as earned by such company in its home country for purposes of such country’s tax laws. Exempt contracts are defined under section 953(e)(2) to include insurance or annuity contracts issued by a qualifying insurance company in connection with the lives or health of residents of a country other than the U.S. but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3).

In general, section 953(e)(3) defines a “qualifying insurance company” as any CFC that: (A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country; (B) derives more than 50 percent of its aggregate net written premiums from the issuance by such controlled foreign corporation of contracts covering applicable home country risks of such corporation and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)); and (C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 954(a)(1) defines the term “foreign base company income” to include, among other types of income, foreign personal holding company income. Section 954(c)(1) sets forth the types of income that are considered to be foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company”.

Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. First, income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section

954(i)(4)). Second, income received from unrelated persons and derived from investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts.

Section 816(a) defines the term “life insurance company” as an insurance company that is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with accident and health insurance), or noncancellable contracts of health and accident insurance, if (1) its life insurance reserves plus (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, accident, or health policies not included in life insurance reserves, comprise more than 50 percent of its total reserves. For purposes of the preceding sentence, “insurance company” means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

Section 816(b)(1) defines the term “life insurance reserve” as amounts (A) computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and (B) that are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable accident and health insurance contracts (including life insurance or annuity contracts combined with noncancellable accident and health insurance) involving, at the time with respect to which the reserve is computed, life, accident, or health contingencies.

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserves under section 954(i)(4)(B)(i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

Section 954(i)(4)(B)(ii) was originally enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, 12/18/2015), section 954(i) was permanently extended and made effective for taxable years of foreign corporations beginning after

December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end. In its Technical Explanation to the PATH Act, the staff of the Joint Committee on Taxation explains section 954(i)(4)(B)(ii) as follows:

The provision does, however, permit a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve for such contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Joint Comm. on Taxation, Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40) (JCX-144-15 (December 17, 2015)).

Analysis

CFC is subject to regulation as an insurer of life insurance, annuities, and noncancellable and guaranteed renewable A&H insurance contracts in Country A. CFC is licensed and regulated by Regulator, which is the insurance regulatory body for Country A, to issue life insurance and annuity contracts to persons other than related persons within the meaning of section 954(d)(3)) in Country A. Parent has also represented that CFC is engaged in the life insurance business in Country A and would be subject to tax under Subchapter L if it were a domestic corporation. Parent has represented that CFC derives more than 50 percent of its aggregate net written premiums from the issuance by CFC of life insurance contracts to persons other than related persons (as defined in section 954(d)(3)). Accordingly, CFC is a QIC under section 953(e)(3).

CFC issues life insurance contracts in connection with the lives and health of residents of Country A, a country other than the United States. CFC derives more than 30 percent of its net written premiums from contracts that cover Country A risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Life insurance contracts issued by CFC are therefore exempt contracts within the meaning of section 953(e)(2).

CFC must establish, maintain, and calculate its underwriting reserves and loss reserves in accordance with the insurance laws and regulations prescribed by Regulator. Regulator generally requires a life insurance company to determine the

amount of its underwriting reserves and loss reserves based on guidance provided by Regulator. CFC must set forth its underwriting reserves and loss reserves on the Country A annual report, which must be filed annually with Regulator. These reserves are the measure of the legal obligations to policyholders on the financial statement used for regulatory purposes by life insurance companies doing business in Country A (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries). Regulator requires CFC to hold its underwriting reserves and loss reserves for the fulfillment of claims owed to policyholders and beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. Under the rules prescribed by Regulator for determining reserves required to be calculated for purposes of the Country A annual report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

CFC issues noncancellable and guaranteed renewable A&H contracts and riders to life insurance contracts as part of its life insurance business. For Country A tax and insurance regulatory purposes, CFC computes the underwriting reserves and loss reserves on these policies using a methodology similar to that used to compute life insurance reserves. The treatment of noncancellable and guaranteed renewable A&H contracts as life insurance contracts, the reserves for which are computed as life insurance reserves, is consistent with the treatment of such reserves for standard actuarial, local regulatory, local tax, and U.S. GAAP purposes. Under the rules prescribed by Regulator for determining reserves required to be calculated for purposes of the Country A annual report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

Ruling

Based on the information submitted and the representations made, we rule as follows:

- (1) Under the facts set forth above, the foreign statement underwriting reserves and loss reserves maintained by CFC with respect to its exempt life insurance contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC under section 954(i).
- (2) Under the facts set forth above, the foreign statement underwriting reserves and loss reserves maintained by CFC for its noncancellable and guaranteed renewable accident and health contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC under section 954(i).

Caveats

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling. This ruling will be subject to revocation if any of the following circumstances occurs: (1) a change in the material facts on which this ruling was based; (2) a material change in the business circumstances of CFC which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to the current reserving method of CFC.

Procedural Statements

This ruling is directed only to CFC. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Steven D. Jensen
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(International)